TIFFANY & CO
Form 10-Q
August 27, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 31, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 1-9494

TIFFANY & CO.
(Exact name of registrant as specified in its charter)

| Delaware | 13-3228013 |
|---|---|
| (State of incorporation) | (I.R.S. Employer Identification No.) |
| 727 Fifth Avenue, New York, NY | 10022 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (212) 755-8000

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| Large accelerated filer | x | Accelerated filer | ¨ |
|---|---|---|---|
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: Common Stock, $.01 par value, 129,294,784 shares outstanding at the close of business on July 31, 2014.

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FOR THE QUARTER ENDED JULY 31, 2014


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PART I. Financial Information
Item 1. Financial Statements
TIFFANY & CO. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except per share amounts)

| | July 31, 2014 | January 31, 2014 | July 31, 2013 |
|---|---|---|---|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | $398,242 | $345,778 | $489,664 |
| Short-term investments | 192 | 21,257 | 118 |
| Accounts receivable, less allowances of $9,537, $10,337 and $8,918 | 190,318 | 188,814 | 161,746 |
| Inventories, net | 2,531,451 | 2,326,580 | 2,328,510 |
| Deferred income taxes | 104,909 | 101,012 | 77,948 |
| Prepaid expenses and other current assets | 225,863 | 244,947 | 181,931 |
| Total current assets | 3,450,975 | 3,228,388 | 3,239,917 |
| Property, plant and equipment, net | 857,317 | 855,095 | 814,593 |
| Deferred income taxes | 246,156 | 278,390 | 309,823 |
| Other assets, net | 381,377 | 390,478 | 367,385 |
| | $4,935,825 | $4,752,351 | $4,731,718 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Short-term borrowings | $275,433 | $252,365 | $207,412 |
| Accounts payable and accrued liabilities | 300,781 | 342,090 | 276,810 |
| Income taxes payable | 28,374 | 31,976 | 36,731 |
| Merchandise and other customer credits | 65,510 | 70,309 | 67,921 |
| Total current liabilities | 670,098 | 696,740 | 588,874 |
| Long-term debt | 750,070 | 751,154 | 756,807 |
| Pension/postretirement benefit obligations | 279,502 | 268,112 | 342,361 |
| Deferred gains on sale-leasebacks | 77,858 | 81,865 | 86,688 |
| Other long-term liabilities | 213,869 | 220,512 | 221,692 |
| Commitments and contingencies | | | |
| Stockholders' equity: | | | |
| Preferred Stock, $0.01 par value; authorized 2,000 shares, none issued and outstanding | — | — | — |
| Common Stock, $0.01 par value; authorized 240,000 shares, issued and outstanding 129,295, 128,312 and 127,945 | 1,293 | 1,283 | 1,279 |
| Additional paid-in capital | 1,152,139 | 1,095,304 | 1,061,849 |
| Retained earnings | 1,824,220 | 1,682,398 | 1,778,490 |
| Accumulated other comprehensive loss, net of tax | (47,273) | (58,548) | (119,318) |
| Total Tiffany & Co. stockholders' equity | 2,930,379 | 2,720,437 | 2,722,300 |
| Non-controlling interests | 14,049 | 13,531 | 12,996 |
| Total stockholders' equity | 2,944,428 | 2,733,968 | 2,735,296 |
| | $4,935,825 | $4,752,351 | $4,731,718 |

See notes to condensed consolidated financial statements.

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TIFFANY & CO. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)
(in thousands, except per share amounts)

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net sales | $992,930 | $925,884 | $2,005,062 | $1,821,368 |
| Cost of sales | 397,767 | 393,755 | 820,373 | 786,015 |
| Gross profit | 595,163 | 532,129 | 1,184,689 | 1,035,353 |
| Selling, general and administrative expenses | 386,642 | 355,243 | 766,375 | 717,309 |
| Earnings from operations | 208,521 | 176,886 | 418,314 | 318,044 |
| Interest and other expenses, net | 16,151 | 14,694 | 32,427 | 27,406 |
| Earnings from operations before income taxes | 192,370 | 162,192 | 385,887 | 290,638 |
| Provision for income taxes | 68,250 | 55,411 | 136,158 | 100,280 |
| Net earnings | $124,120 | $106,781 | $249,729 | $190,358 |
| Net earnings per share: | | | | |
| Basic | $0.96 | $0.84 | $1.93 | $1.49 |
| Diluted | $0.96 | $0.83 | $1.92 | $1.48 |
| Weighted-average number of common shares: | | | | |
| Basic | 129,252 | 127,826 | 129,093 | 127,572 |
| Diluted | 129,908 | 128,771 | 129,851 | 128,606 |

See notes to condensed consolidated financial statements.

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TIFFANY & CO. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS
(Unaudited)
(in thousands)

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net earnings | $124,120 | $106,781 | $249,729 | $190,358 |
| Other comprehensive (loss) earnings, net of tax | | | | |
| Foreign currency translation adjustments | (4,955) | (15,346) | 12,196 | (30,784) |
| Unrealized (loss) gain on marketable securities | (513) | (920) | 254 | (105) |
| Unrealized loss on hedging instruments | (1,297) | (2,977) | (4,776) | (190) |
| Net unrealized gain on benefit plans | 1,559 | 2,712 | 3,601 | 5,636 |
| Total other comprehensive (loss) earnings, net of tax | (5,206) | (16,531) | 11,275 | (25,443) |
| Comprehensive earnings | $118,914 | $90,250 | $261,004 | $164,915 |

See notes to condensed consolidated financial statements.

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TIFFANY & CO. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(in thousands)

| | Total Stockholders' Equity | Retained Earnings | Accumulated Other Comprehensive Loss | Common Stock | | Additional Paid-In Capital | Non-controlling Interests |
|---|---|---|---|---|---|---|---|
| | | | | Shares | Amount | | |
| Balances, January 31, 2014 | $ 2,733,968 | $ 1,682,398 | $ (58,548) | 128,312 | $ 1,283 | $ 1,095,304 | $ 13,531 |
| Exercise of stock options and vesting of restricted stock units ("RSUs") | 29,307 | — | — | 1,122 | 12 | 29,295 | — |
| Tax effect of exercise of stock options and vesting of RSUs | 12,504 | — | — | — | — | 12,504 | — |
| Share-based compensation expense | 13,534 | — | — | — | — | 13,534 | — |
| Issuance of Common Stock under Employee Profit Sharing and Retirement Savings Plan | 3,925 | — | — | 45 | — | 3,925 | — |
| Purchase and retirement of Common Stock | (16,402) | (15,058) | — | (184) | (2) | (1,342) | — |
| Cash dividends on Common Stock | (92,849) | (92,849) | — | — | — | — | — |
| Other comprehensive earnings, net of tax | 11,275 | — | 11,275 | — | — | — | — |
| Net earnings | 249,729 | 249,729 | — | — | — | — | — |
| Redemption of non-controlling interest | — | — | — | — | — | (1,081) | 1,081 |
| Non-controlling interests | (563) | — | — | — | — | — | (563) |
| Balances, July 31, 2014 | $ 2,944,428 | $ 1,824,220 | $ (47,273) | 129,295 | $ 1,293 | $ 1,152,139 | $ 14,049 |

See notes to condensed consolidated financial statements.

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TIFFANY & CO. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

| | Six Months Ended July 31, 2014 | 2013 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings | $249,729 | $190,358 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 97,214 | 86,323 |
| Amortization of gain on sale-leasebacks | (4,744) | (4,733) |
| Excess tax benefits from share-based payment arrangements | (12,504) | (10,832) |
| Provision for inventories | 14,741 | 17,421 |
| Deferred income taxes | 19,569 | (8,343) |
| Provision for pension/postretirement benefits | 19,655 | 24,505 |
| Share-based compensation expense | 13,398 | 15,309 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (200) | 6,673 |
| Inventories | (213,332) | (143,437) |
| Prepaid expenses and other current assets | (23,257) | (26,505) |
| Accounts payable and accrued liabilities | (19,504) | (22,857) |
| Income taxes payable | 28,263 | 20,196 |
| Merchandise and other customer credits | (5,125) | 2,018 |
| Other, net | (11,107) | (26,016) |
| Net cash provided by operating activities | 152,796 | 120,080 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of marketable securities and short-term investments | (698) | (616) |
| Proceeds from sales of marketable securities and short-term investments | 21,729 | — |
| Capital expenditures | (91,126) | (86,686) |
| Notes receivable funded | — | (3,050) |
| Proceeds from notes receivable | 7,277 | 484 |
| Net cash used in investing activities | (62,818) | (89,868) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from credit facility borrowings, net | 13,966 | 3,244 |
| Other proceeds from credit facility borrowings | 12,067 | 82,643 |
| Other repayments of credit facility borrowings | (964) | (68,100) |
| Repurchase of Common Stock | (16,402) | — |
| Proceeds from exercised stock options | 35,305 | 15,505 |
| Excess tax benefits from share-based payment arrangements | 12,504 | 10,832 |
| Cash dividends on Common Stock | (92,849) | (83,209) |
| Distribution to non-controlling interest | (1,910) | — |
| Financing fees | (97) | (893) |
| Net cash used in financing activities | (38,380) | (39,978) |
| Effect of exchange rate changes on cash and cash equivalents | 866 | (5,408) |
| Net increase/(decrease) in cash and cash equivalents | 52,464 | (15,174) |
| Cash and cash equivalents at beginning of year | 345,778 | 504,838 |
| Cash and cash equivalents at end of six months | $398,242 | $489,664 |

See notes to condensed consolidated financial statements.

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TIFFANY & CO. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated financial statements include the accounts of Tiffany & Co. (also referred to as the Registrant) and its subsidiaries (the “Company”) in which a controlling interest is maintained. Controlling interest is determined by majority ownership interest and the absence of substantive third-party participating rights or, in the case of variable interest entities (VIEs), if the Company has the power to significantly direct the activities of a VIE, as well as the obligation to absorb significant losses of or the right to receive significant benefits from the VIE. Intercompany accounts, transactions and profits have been eliminated in consolidation. The interim statements are unaudited and, in the opinion of management, include all adjustments (which represent normal recurring adjustments) necessary to fairly state the Company’s financial position as of July 31, 2014 and 2013 and the results of its operations and cash flows for the interim periods presented. The condensed consolidated balance sheet data for January 31, 2014 is derived from the audited financial statements, which are included in the Company’s Annual Report on Form 10-K and should be read in connection with these financial statements. As permitted by the rules of the Securities and Exchange Commission, these financial statements do not include all disclosures required by generally accepted accounting principles.

The Company’s business is seasonal in nature, with the fourth quarter typically representing approximately one-third of annual net sales and a higher percentage of annual net earnings. Therefore, the results of its operations for the three and six months ended July 31, 2014 and 2013 are not necessarily indicative of the results of the entire fiscal year.

2. NEW ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 – Revenue From Contracts with Customers, to clarify the principles of recognizing revenue and create common revenue recognition guidance between U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards. The core principle of the guidance is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. This ASU is effective retrospectively for fiscal years and interim periods within those years beginning after December 15, 2016 and early adoption is not permitted. Management is currently evaluating the impact of this ASU on the condensed consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12 – Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period which requires a reporting entity to treat a performance target that affects vesting and that could be achieved after the requisite service period as a performance condition, and to apply existing guidance as it relates to awards with performance conditions that affect vesting to account for such awards. The provisions of this ASU are effective for interim and annual periods beginning after December 15, 2015. This ASU is not expected to have a material impact on the condensed consolidated financial statements or disclosures.

3. RECEIVABLES AND FINANCING ARRANGEMENTS

Receivables. The Company maintains an allowance for doubtful accounts for estimated losses associated with the accounts receivable recorded on the balance sheet. The allowance is determined based on a combination of factors including, but not limited to, the length of time that the receivables are past due,

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management's knowledge of the customer, economic and market conditions and historical write-off experiences.

For the receivables associated with Tiffany & Co. credit cards ("Credit Card Receivables"), management uses various indicators to determine whether to extend credit to customers and the amount of credit. Such indicators include reviewing prior experience with the customer, including sales and collection history, and using applicants' credit reports and scores provided by credit rating agencies. Credit Card Receivables require minimum balance payments. A Credit Card account is classified as overdue if a minimum balance payment has not been received within the allotted timeframe (generally 30 days), after which internal collection efforts commence. For all Credit Card Receivables recorded on the balance sheet, once all internal collection efforts have been exhausted and management has reviewed the account, the account balance is written off and may be sent for external collection or legal action. At July 31, 2014 and 2013, the carrying amount of the Credit Card Receivables (recorded in accounts receivable, net) was $55,690,000 and $49,948,000, of which 97% were considered current in both periods. The allowance for doubtful accounts for estimated losses associated with the Credit Card Receivables (approximately $1,000,000 at July 31, 2014 and $1,500,000 at July 31, 2013) was determined based on the factors discussed above. Finance charges earned on Credit Card accounts are not significant.

Financing Arrangements. The Company may, from time to time, provide financing to diamond mining and exploration companies in order to obtain rights to purchase the mine's output. Management evaluates these and any other financing arrangements that may arise for potential impairment by reviewing the parties' financial statements and projections and business, operational and other economic factors on a periodic basis. At July 31, 2014 and 2013, the current portion of the carrying amount of financing arrangements including accrued interest was $17,059,000 and $7,807,000 and was recorded in prepaid expenses and other current assets. At July 31, 2014 and 2013, the non-current portion of the carrying amount of financing arrangements including accrued interest was $49,231,000 and $64,425,000 and was included in other assets, net. The Company has not recorded any material impairment charges on such loans as of July 31, 2014 and 2013.

## 4. INVENTORIES

| (in thousands) | July 31, 2014 | January 31, 2014 | July 31, 2013 |
|---|---|---|---|
| Finished goods | $1,453,175 | $1,333,926 | $1,370,966 |
| Raw materials | 933,311 | 874,799 | 843,380 |
| Work-in-process | 144,965 | 117,855 | 114,164 |
| Inventories, net | $2,531,451 | $2,326,580 | $2,328,510 |

## 5. INCOME TAXES

The effective income tax rate for the three months ended July 31, 2014 was 35.5% versus 34.2% in the prior year. The effective income tax rate for the three months ended July 31, 2014 includes an increase of 0.6 percentage point due to the one-time impact of a change in state tax legislation. The effective income tax rate for the six months ended July 31, 2014 was 35.3% versus 34.5% in the prior year. The effective income tax rate for the six months ended July 31, 2014 includes an increase of 1.3 percentage points due to the one-time impact of changes in state tax legislation offset by the favorable impact of a valuation allowance release of 0.6 percentage point.

At July 31, 2014, the Company’s gross uncertain tax positions decreased by $20,231,000 from January 31, 2014 primarily as a result of the settlement of an audit conducted by the Internal Revenue Service ("IRS"). At July 31, 2014, gross accrued interest and penalties decreased by $4,605,000 from January 31, 2014, primarily due to the settlement of the IRS audit. These decreases were primarily a result of payments due to federal and state taxing authorities. The effect of this settlement on the Condensed

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Consolidated Statements of Earnings was not material for the three and six months ended July 31, 2014.

The Company conducts business globally, and as a result, is subject to taxation in the U.S. and various state and foreign jurisdictions. As a matter of course, tax authorities regularly audit the Company. The Company's tax filings are currently being examined by a number of tax authorities in several jurisdictions. An audit is currently being conducted by the IRS (tax years 2010–2011). Tax years from 2006–present are open to examination in U.S. Federal and various state, local and foreign jurisdictions. As part of these audits, the Company engages in discussions with the taxing authorities regarding tax positions. As of July 31, 2014, unrecognized tax benefits are not expected to change materially in the next 12 months. Future developments may result in a change in this assessment.

## 6. EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed as net earnings divided by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the dilutive effect of the assumed exercise of stock options and unvested restricted stock units.

The following table summarizes the reconciliation of the numerators and denominators for the basic and diluted EPS computations:

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| (in thousands) | 2014 | 2013 | 2014 | 2013 |
| Net earnings for basic and diluted EPS | $124,120 | $106,781 | $249,729 | $190,358 |
| Weighted-average shares for basic EPS | 129,252 | 127,826 | 129,093 | 127,572 |
| Incremental shares based upon the assumed exercise of stock options and unvested restricted stock units | 656 | 945 | 758 | 1,034 |
| Weighted-average shares for diluted EPS | 129,908 | 128,771 | 129,851 | 128,606 |

For the three months ended July 31, 2014 and 2013, there were 347,000 and 412,000 stock options and restricted stock units excluded from the computations of earnings per diluted share due to their antidilutive effect. For the six months ended July 31, 2014 and 2013, there were 336,000 and 589,000 stock options and restricted stock units excluded from the computations of earnings per diluted share due to their antidilutive effect.

## 7. HEDGING INSTRUMENTS

Background Information

The Company uses derivative financial instruments, including interest rate swaps, forward contracts and put option contracts to mitigate a portion of its exposures to changes in interest rates, foreign currency and precious metal prices. Derivative instruments are recorded on the consolidated balance sheet at their fair values, as either assets or liabilities, with an offset to current or comprehensive earnings, depending on whether the derivative is designated as part of an effective hedge transaction and, if it is, the type of hedge transaction. If a derivative instrument meets certain hedge accounting criteria, it is designated as one of the following on the date it is entered into:

- Fair Value Hedge – A hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment. For fair value hedge transactions, both the effective and ineffective portions of the changes in the fair value of the derivative and changes in the fair value of the item being hedged are recorded in

current earnings.

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- Cash Flow Hedge – A hedge of the exposure to variability in the cash flows of a recognized asset, liability or a forecasted transaction. For cash flow hedge transactions, the effective portion of the changes in fair value of derivatives are reported as other comprehensive income ("OCI") and are recognized in current earnings in the period or periods during which the hedged transaction affects current earnings. Amounts excluded from the effectiveness calculation and any ineffective portions of the change in fair value of the derivative are recognized in current earnings.

The Company formally documents the nature of and relationships between the hedging instruments and hedged items for a derivative to qualify as a hedge at inception and throughout the hedged period. The Company also documents its risk management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of a forecasted transaction must be identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss on the derivative financial instrument would be recognized in current earnings. Derivative financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedge instrument and the item being hedged, both at inception and throughout the hedged period.

The Company does not use derivative financial instruments for trading or speculative purposes.

Types of Derivative Instruments

Interest Rate Swaps – In 2012, the Company entered into forward-starting interest rate swaps to hedge the impact of interest rate volatility on future interest payments associated with the anticipated incurrence of $250,000,000 of additional debt which was incurred in July 2012. The Company accounted for the forward-starting interest rate swaps as cash flow hedges.

Foreign Exchange Forward and Put Option Contracts – The Company uses foreign exchange forward contracts or put option contracts to offset the foreign currency exchange risks associated with foreign currency-denominated exposures, intercompany transactions and forecasted purchases of merchandise between entities with differing functional currencies. For put option contracts, if the market exchange rate at the time of the put option contract's expiration is stronger than the contracted exchange rate, the Company allows the put option contract to expire, limiting its loss to the cost of the put option contract. The Company assesses hedge effectiveness based on the total changes in the foreign exchange forward and put option contracts' cash flows. These foreign exchange forward contracts and put option contracts are designated and accounted for as either cash flow hedges or economic hedges that are not designated as hedging instruments.

As of July 31, 2014, the notional amount of foreign exchange forward contracts accounted for as cash flow hedges was $163,106,000 and the notional amount of foreign exchange forward contracts accounted for as undesignated hedges was $57,027,000. The term of all outstanding foreign exchange forward contracts as of July 31, 2014 ranged from less than one month to 12 months.

Precious Metal Forward Contracts – The Company periodically hedges a portion of its forecasted purchases of precious metals for use in its internal manufacturing operations through the use of forward contracts in order to minimize the effect of volatility in precious metal prices. The Company accounts for its precious metal forward contracts as cash flow hedges. The Company assesses hedge effectiveness based on the total changes in the precious metal forward contracts' cash flows. The maximum term over which the Company is hedging its exposure to the variability of future cash flows for all forecasted transactions is 12 months. As of July 31, 2014, there were precious metal derivative instruments outstanding for approximately 14,900 ounces of platinum and 454,100 ounces of silver.

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Information on the location and amounts of derivative gains and losses in the condensed consolidated financial statements is as follows:

| | Three Months Ended July 31, | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| (in thousands) | Pre-Tax Gain Recognized in OCI (Effective Portion) | Pre-Tax Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) | Pre-Tax Gain (Loss) Recognized in OCI (Effective Portion) | Pre-Tax Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) |
| Derivatives in Cash Flow Hedging Relationships: | | | | |
| Foreign exchange forward contracts [a] | $591 | $5,474 | $191 | $3,139 |
| Put option contracts [a] | — | — | (8) | 662 |
| Precious metal forward contracts [a] | 1,396 | (1,237) | (2,415) | (1,008) |
| Forward-starting interest rate swaps [b] | — | (369) | — | (386) |
| | $1,987 | $3,868 | $(2,232) | $2,407 |

| | Six Months Ended July 31, | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| (in thousands) | Pre-Tax Gain Recognized in OCI (Effective Portion) | Pre-Tax Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) | Pre-Tax Gain (Loss) Recognized in OCI (Effective Portion) | Pre-Tax Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) |
| Derivatives in Cash Flow Hedging Relationships: | | | | |
| Foreign exchange forward contracts [a] | $447 | $12,847 | $9,367 | $5,068 |
| Put option contracts [a] | — | — | 1,270 | 930 |
| Precious metal forward contracts [a] | 1,808 | (2,740) | (7,399) | (1,933) |
| Forward-starting interest rate swaps [b] | — | (742) | — | (776) |
| | $2,255 | $9,365 | $3,238 | $3,289 |

[a] The gain or loss recognized in earnings is included within Cost of sales.

[b] The gain or loss recognized in earnings is included within Interest and other expenses, net.

The gains and losses on derivatives not designated as hedging instruments were not significant in the periods ended July 31, 2014 and 2013. There was no material ineffectiveness related to the Company's hedging instruments for the periods ended July 31, 2014 and 2013. The Company expects approximately $3,800,000 of net pre-tax derivative gains included in accumulated other comprehensive income at July 31, 2014 will be reclassified into earnings within the next 12 months. This amount will vary due to fluctuations in foreign currency exchange rates and precious metal prices.

For information regarding the location and amount of the derivative instruments in the Condensed Consolidated Balance Sheet, see "Note 8. Fair Value of Financial Instruments."

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Concentration of Credit Risk

A number of major international financial institutions are counterparties to the Company's derivative financial instruments. The Company enters into derivative financial instrument agreements only with counterparties meeting certain credit standards (a credit rating of A/A2 or better at the time of the agreement) and limits the amount of agreements or contracts it enters into with any one party. The Company may be exposed to credit losses in the event of nonperformance by individual counterparties or the entire group of counterparties.

## 8. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. U.S. GAAP prescribes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities. Level 1 inputs are considered to carry the most weight within the fair value hierarchy due to the low levels of judgment required in determining fair values.

Level 2 – Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3 – Unobservable inputs reflecting the reporting entity's own assumptions. Level 3 inputs are considered to carry the least weight within the fair value hierarchy due to substantial levels of judgment required in determining fair values.

The Company uses the market approach to measure fair value for its marketable securities and derivative instruments. The Company's foreign exchange forward contracts, as well as its put option contracts, are primarily valued using the appropriate foreign exchange spot rates. The Company's precious metal forward contracts are primarily valued using the relevant precious metal spot rate. For further information on the Company's hedging instruments and program, see "Note 7. Hedging Instruments."

Financial assets and liabilities carried at fair value at July 31, 2014 are classified in the table below in one of the three categories described above:

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Marketable securities [a] | $53,362 | $53,362 | $— | $— | $53,362 |
| Derivatives designated as hedging instruments: | | | | | |
| Precious metal forward contracts [b] | 663 | — | 663 | — | 663 |
| Foreign exchange forward contracts [b] | 3,354 | — | 3,354 | — | 3,354 |
| Total financial assets | $57,379 | $53,362 | $4,017 | $— | $57,379 |

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Derivatives designated as hedging instruments: | | | | | |
| Precious metal forward contracts [c] | $241 | $— | $241 | $— | $241 |
| Foreign exchange forward contracts [c] | 226 | — | 226 | — | 226 |
| Total financial liabilities | $467 | $— | $467 | $— | $467 |

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Financial assets and liabilities carried at fair value at July 31, 2013 are classified in the table below in one of the three categories described above:

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Marketable securities [a] | $49,343 | $49,343 | $— | $— | $49,343 |
| Derivatives designated as hedging instruments: | | | | | |
| Precious metal forward contracts [b] | 212 | — | 212 | — | 212 |
| Foreign exchange forward contracts [b] | 18,744 | — | 18,744 | — | 18,744 |
| Total financial assets | $68,299 | $49,343 | $18,956 | $— | $68,299 |

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Derivatives designated as hedging instruments: | | | | | |
| Precious metal forward contracts [c] | $3,470 | $— | $3,470 | $— | $3,470 |
| Foreign exchange forward contracts [c] | 617 | — | 617 | — | 617 |
| Total financial liabilities | $4,087 | $— | $4,087 | $— | $4,087 |

aIncluded within Other assets, net.
bIncluded within Prepaid expenses and other current assets.
cIncluded within Accounts payable and accrued liabilities.

The fair value of derivatives not designated as hedging instruments was not significant in the periods ended July 31, 2014 and 2013. The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximates carrying value due to the short-term maturities of these assets and liabilities and would be measured using Level 1 inputs. The fair value of debt with variable interest rates approximates carrying value and is measured using Level 2 inputs. The fair value of debt with fixed interest rates was determined using the quoted market prices of debt instruments with similar terms and maturities, which are considered Level 2 inputs. The total carrying value of short-term borrowings and long-term debt was $1,025,503,000 and $964,219,000 and the corresponding fair value was approximately $1,100,000,000 at both July 31, 2014 and 2013.

9. COMMITMENTS AND CONTINGENCIES

Arbitration Award.  On December 21, 2013, an award (the "Arbitration Award") was issued in favor of The Swatch Group Ltd. ("Swatch") and its wholly-owned subsidiary Tiffany Watch Co. ("Watch Company"; Swatch and Watch Company, together, the "Swatch Parties") in an arbitration proceeding (the "Arbitration") between the Registrant and its wholly-owned subsidiaries, Tiffany and Company and Tiffany (NJ) Inc. (the Registrant and such subsidiaries, together, the "Tiffany Parties") and the Swatch Parties.

The Arbitration was initiated in June 2011 by the Swatch Parties, who sought damages for alleged breach of agreements entered into by and among the Swatch Parties and the Tiffany Parties in December 2007 (the "Agreements"), and the hearing was held in October 2012 before a three-member arbitral panel convened in the Netherlands pursuant to the Arbitration Rules of the Netherlands Arbitration Institute. The Agreements pertained to the development and commercialization of a watch business and, among other things, contained various licensing and governance provisions and approval requirements relating to business, marketing and branding plans and provisions allocating profits relating to sales of the watch business between the Swatch Parties and the Tiffany Parties.

In general terms, the Swatch Parties alleged that the Tiffany Parties breached the Agreements by obstructing and delaying development of Watch Company's business and otherwise failing to proceed in

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good faith. The Swatch Parties sought damages based on alternate theories ranging from CHF 73,000,000 (or approximately $80,000,000 at July 31, 2014) (based on its alleged wasted investment) to CHF 3,800,000,000 (or approximately $4,200,000,000 at July 31, 2014) (calculated based on alleged future lost profits of the Swatch Parties and their affiliates over the entire term of the Agreements).

In the Arbitration, the Tiffany Parties defended against the Swatch Parties' claims vigorously, disputing both the merits of the claims and the calculation of the alleged damages. The Tiffany Parties also asserted counterclaims for damages attributable to breach by the Swatch Parties, stemming from the Swatch Parties' September 12, 2011 public issuance of a Notice of Termination purporting to terminate the Agreements due to alleged material breach by the Tiffany Parties, and for termination due to such breach. In general terms, the Tiffany Parties alleged that the Swatch Parties did not have grounds for termination, failed to meet the high standard for proving material breach set forth in the Agreements and failed to provide appropriate management, distribution, marketing and other resources for TIFFANY & CO. brand watches and to honor their contractual obligations to the Tiffany Parties regarding brand management. The Tiffany Parties' counterclaims sought damages based on alternate theories ranging from CHF 120,000,000 (or approximately $132,000,000 at July 31, 2014) (based on its wasted investment) to approximately CHF 540,000,000 (or approximately $594,000,000 at July 31, 2014) (calculated based on alleged future lost profits of the Tiffany Parties).

Under the terms of the Arbitration Award, and at the request of the Swatch Parties and the Tiffany Parties, the Agreements were deemed terminated as of March 1, 2013. Pursuant to the Arbitration Award, the Tiffany Parties were ordered to pay the Swatch Parties damages of CHF 402,737,000 (the "Arbitration Damages"), as well as interest from June 30, 2012 to the date of payment, two-thirds of the cost of the Arbitration and two-thirds of the Swatch Parties' legal fees, expenses and costs. These amounts were paid in full in January 2014, and, in the fourth quarter of 2013, the Company recorded a charge of $480,211,000 which was classified as Arbitration award expense in the consolidated statement of earnings for the fiscal year ended January 31, 2014.

On March 31, 2014, the Tiffany Parties took action in the courts of the Netherlands to annul the Arbitration Award. Generally, arbitration awards are final; however, Dutch law does provide for limited grounds on which arbitral awards may be set aside. The Tiffany Parties have petitioned to annul the Arbitration Award on these statutory grounds. These grounds include, for example, that the arbitral tribunal violated its mandate by changing the express terms of the Agreements.

Management expects that the annulment action will not be ultimately resolved for at least two years; however, if the Arbitration Award is finally annulled, management anticipates that the claims and counterclaims that formed the basis of the Arbitration, and potentially additional claims and counterclaims, will be litigated in court proceedings between and among the Swatch Parties and the Tiffany Parties. The identity and location of the courts that would hear such actions cannot be determined at this time.

In any such litigation, issues of liability and damages will be pled and determined without regard to the findings of the arbitral panel. As such, it is possible that the court could find that the Swatch Parties were in material breach of their obligations under the Agreements, that the Tiffany Parties were in material breach of their obligations under the Agreements or that neither the Swatch Parties nor the Tiffany Parties were in material breach. If the Swatch Parties' claims of liability were accepted by the court, the damages award cannot be reasonably estimated at this time, but could exceed the Arbitration Damages and could have a material adverse effect on the Company's consolidated financial statements or liquidity.

Management has not established any accrual in the Company's condensed consolidated financial statements as of July 31, 2014 related to the annulment process or any potential subsequent litigation because it does not believe that an annulment of the Arbitration Award and the subsequent award of damages exceeding the Arbitration Damages is probable.

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The Company is proceeding with plans to design, produce, market and distribute TIFFANY & CO. brand watches through a Swiss subsidiary. The effective development and growth of this watch business will require additional resources and will involve risks and uncertainties.

Other Litigation Matters. The Company is from time to time involved in routine litigation incidental to the conduct of its business, including proceedings to protect its trademark rights, litigation with parties claiming infringement of patents and other intellectual property rights by the Company, litigation instituted by persons alleged to have been injured upon premises under the Company's control and litigation with present and former employees and customers. Although litigation with present and former employees is routine and incidental to the conduct of the Company's business, as well as for any business employing significant numbers of employees, such litigation can result in large monetary awards when a civil jury is allowed to determine compensatory and/or punitive damages for actions claiming discrimination on the basis of age, gender, race, religion, disability or other legally-protected characteristic or for termination of employment that is wrongful or in violation of implied contracts. However, the Company believes that litigation currently pending to which it is a party or to which its properties are subject will be resolved without any material adverse effect on the Company's financial position, earnings or cash flows.

Environmental Matter. In 2005, the US Environmental Protection Agency ("EPA") designated a 17-mile stretch of the Passaic River (the "River") part of the Diamond Alkali "Superfund" site. This designation resulted from the detection of hazardous substances at the site, which was previously home to the Diamond Shamrock Corporation, a manufacturer of pesticides and herbicides. Under the Superfund law, the EPA will negotiate with potentially responsible parties to agree on remediation approaches.

The Company, which operated a silverware manufacturing facility on a tributary of the River from approximately 1897 to 1985, is one of more than 300 parties (the "Potentially Responsible Parties") designated by the EPA as potentially responsible parties with respect to the River. Of these parties, the Company, along with approximately 70 other Potentially Responsible Parties (collectively, the "Cooperating Parties Group" or "CPG") voluntarily entered into an Administrative Settlement Agreement and Order on Consent ("AOC") with the EPA in May 2007 to perform a Remedial Investigation/Feasibility Study (the "RI/FS") of the lower 17 miles of the River. In June 2012, the CPG voluntarily entered into a second AOC related to focused remediation actions at Mile 10.9 of the River. The RI/FS under the 2007 AOC and the actions under the Mile 10.9 AOC are expected to be substantially complete by the end of 2014. The Company has accrued for its financial obligations under both AOCs, which have not been material to its financial position or results of operations in previous financial periods or on a cumulative basis.

Separately, the EPA has issued and is reviewing comments on its proposed plan for remediating the lower eight miles of the River, which is supported by a Focused Feasibility Study (the "FFS"). The FFS provides multiple approaches to remediation, which range in cost from $360,000,000 to $3,250,000,000, with the cost of the EPA-recommended approach ranging from $950,000,000 to $1,731,000,000. It cannot be determined how any costs of remediation identified as a result of the FFS would be allocated among any of the potentially responsible parties.

The Company expects that the RI/FS, once complete, will be reviewed and subject to comment by the EPA and other governmental agencies and stakeholders, with the EPA ultimately issuing a Record of Decision identifying a proposed remediation approach. With respect to the FFS, the Company expects that the EPA will, after review of the comments, identify and negotiate with any or all of the potentially responsible parties regarding any remediation action that may be necessary, and ultimately issue a Record of Decision with a proposed remediation approach.

Until one or more Records of Decision are issued, neither the ultimate remedial approaches and their costs, nor the Company's participation, if any, relative to the other potentially responsible parties in these approaches and costs, can be determined. As such, the Company's obligations, if any, beyond those already recorded for the 2007 AOC and the Mile 10.9 AOC cannot be estimated at this time, and the Company has therefore not recorded any additional liability

related to this matter. In light of the number of companies in the CPG participating in the 2007 AOC and the Mile 10.9 AOC and the Company's relative participation in the costs related thereto, the Company does not expect that its

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ultimate liability, if any, related to these matters will be material to its financial position. However, it is possible that, when the uncertainties discussed above are resolved, such liability could be material to its results of operations or cash flows in the period in which such uncertainties are resolved.

Leases. In April 2010, Tiffany committed to a plan to consolidate and relocate its New York headquarters staff to a single leased location in Manhattan. The Company recorded accrued exit charges of $30,884,000 during the second quarter of 2011 within other long-term liabilities associated with the relocation. The following is a reconciliation of the remaining accrued exit charges:

| (in thousands) | |
|---|---|
| Balance at January 31, 2014 | $10,465 |
| Cash payments, net of estimated sublease income | (1,518) |
| Interest accretion | 69 |
| Balance at April 30, 2014 | 9,016 |
| Cash payments, net of estimated sublease income | (1,469) |
| Interest accretion | 59 |
| Balance at July 31, 2014 | $7,606 |

10. STOCKHOLDERS' EQUITY

Accumulated Other Comprehensive Loss

| (in thousands) | July 31, 2014 | January 31, 2014 | July 31, 2013 |
|---|---|---|---|
| Accumulated other comprehensive earnings (loss), net of tax: | | | |
| Foreign currency translation adjustments | $29,042 | $16,846 | $13,280 |
| Unrealized gain on marketable securities | 2,931 | 2,677 | 1,744 |
| Deferred hedging loss | (11,383) | (6,607) | (3,397) |
| Net unrealized loss on benefit plans | (67,863) | (71,464) | (130,945) |
| | $(47,273) | $(58,548) | $(119,318) |

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Additions to and reclassifications out of accumulated other comprehensive loss are as follows:

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| (in thousands) | 2014 | 2013 | 2014 | 2013 |
| Foreign currency translation adjustments | $(5,116) | $(15,459) | $12,232 | $(33,352) |
| Income tax benefit (expense) | 161 | 113 | (36) | 2,568 |
| Foreign currency translation adjustments, net of tax | (4,955) | (15,346) | 12,196 | (30,784) |
| Unrealized (loss) gain on marketable securities | (393) | (1,076) | 826 | 190 |
| Income tax (expense) benefit | (120) | 156 | (572) | (295) |
| Unrealized (loss) gain on marketable securities, net of tax | (513) | (920) | 254 | (105) |
| Unrealized gain (loss) on hedging instruments | 1,987 | (2,232) | 2,255 | 3,238 |
| Reclassification adjustment for gain included in net earnings [a] | (3,868) | (2,407) | (9,365) | (3,289) |
| Income tax benefit (expense) | 584 | 1,662 | 2,334 | (139) |
| Unrealized loss on hedging instruments, net of tax | (1,297) | (2,977) | | |